



B A 250: SMALL BUSINESS MANAGEMENT

Lesson 2: Choosing a Form of Ownership and Understanding Franchising

Introduction (1 of 11)

Choosing a Form of Ownership and Understanding Franchising

One of the many decisions you will need to make if you decide to start your own business will have to do with the legal type of business you want. Understanding the different types of legal forms is important, as each organizational form has both potential benefits and potential drawbacks.

If you decide you would like to own a business but you do not want to take on some of the risks associated with it, you may want to consider operating a franchise.

This lesson will provide you with a foundation of knowledge about the different organizational forms and the option of franchising.

Learning Objectives

The readings and questions in the lesson should help you to do the following things:

- Describe the differences and similarities among the three primary legal organizational forms (the sole proprietorship, the partnership, and the corporation).
- Explain the differences among the special tax status, sub-chapter S corporation; the LLC; and the LLP.
- Identify the main factors to consider when choosing an organizational form.
- Investigate several franchises and outline their capital requirements, start-up costs, and royalty fees.
- Explain the pros and cons of franchising, the basic laws governing the franchiser/franchisee relationship, and the importance of franchises within our economy.

Key Terms/Concepts (2 of 11)

Key Terms/Concepts

articles of incorporation

(also known as the certificate of incorporation) the legal documentation required by the incorporating state that identifies the business name, purpose, location, incorporators, stock provisions, and so on; once the incorporation is approved by the state, the articles and the state's approval become the corporate charter

C corporation

a standard corporation under the law with limited liability for its stockholders; taxed as a legal entity; stockholders are taxed for the income earned in the form of stock dividends

corporation

a legal entity formed under law with separate, independent liability from its owners; an artificial entity that is owned by stockholders or shareholders whose liability is limited to the extent of their investment in the business

franchise

a business agreement where a parent company (the franchisor/franchiser) gives exclusive rights to certain products/services, business names, product concepts, or business systems to a local business (the franchisee) in exchange for fees, royalties, and some control over certain aspects of the local business operation

general partnership

all partners share in managing and operating the business and assume personal liability for the acts of the other partners and the business debts

joint venture

a temporary partnership formed by two or more organizations for a specific, limited profit-making purpose

limited liability company

a relatively new form of ownership that combines the individual tax benefits of a partnership with the limited liability benefits of a corporation

limited partnership

a business that is managed by and is the unlimited responsibility of the general partner(s); limited partners do not participate in the management of the business and are financially liable only to the extent of their investment into the business

partnership

a legal association of two or more individuals to co-own a business for the purpose of earning a profit

partnership agreement

(also known as the articles of partnership or co-partnership) the legal document developed at the onset of the partnership that outlines partners' rights, duties, and responsibilities; if no such document exists, the partnership will be governed by the Uniform Partnership Act

S corporation

a special corporation that can be established under the Internal Revenue Service Code if certain provisions are met; retains all of the rights of a C corporation but does not have

double taxation; corporate income is passed on to the owners and taxed at the individual rates

sole proprietorship

a business owned and managed by one individual; the oldest and most popular form of business ownership

unlimited liability

a factor to consider when forming a business. The sole proprietor and the general partner in a partnership typically have unlimited liability. It is legal in the sense that courts will look to see if the owner and business are one in the same. If so, then it can be construed that the owner will be personally liable for the actions of the business, because they are, in essence, one in the same. The owner will be personally liable for the business's debt and can be personally liable if the business is found negligent. Small businesses purchase liability insurance to minimize the personal risk.

Road Map (3 of 11)

Road Map

Readings:	<ul style="list-style-type: none"> • Complete the readings for Lesson 2 listed in the course syllabus. • Read the online commentary for Lesson 2.
Assignments:	<ol style="list-style-type: none"> 1. View the two videos linked in the Lesson 2 assignments. 2. Participate in Discussion Forum 3 (graded). 3. Submit the Service Learning Project Proposed Schedule. 4. Begin the service learning project.

What Type of Ownership Is Right for Me? (4 of 11)

What Type of Ownership Is Right for Me?

The legal form of ownership for the business is one of the key decisions a new entrepreneur must make. It is also one of the *first* decisions that many new business owners make—with limited knowledge! The form of business ownership affects numerous aspects of the business operation: the owners' control, the business taxes, the owners' financial responsibility, the ability to raise capital, the business's perpetuity, and even the amount of paperwork and cost necessary to start the business.

The implications of this decision are so important that it should be one of the initial pieces of in-depth research performed by an entrepreneur. Having an understanding of the various forms of business ownership and the

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advantages and disadvantages of each is not only needed for the initial setup of the business but also when growth or other business changes require a change in the ownership form. Understanding the long-term impact of ownership options can have a significant impact on a business's success and profitability.

In addition to understanding the different forms of ownership for the benefit of the business, a small business owner should also consider numerous personal aspects affecting business operation:

- What kind of time and financial resources do you have to contribute to the business?
- How committed are you to enduring the highs and lows of establishing a business?
- What kinds of stress can you and your family manage?
- What kinds of skills and business knowledge do you have? (You may want to seek outside feedback on your skills and abilities.)

These kinds of practical considerations should be evaluated when selecting a form of ownership, because each form affects your personal commitment differently. As an entrepreneur, you must match your strengths and weaknesses to the form of ownership.

The following video (Costa, 2012) outlines the types of small businesses and their characteristics.

Video 2.1. Tutorial: Types of Businesses



Time: 00:04:17

No transcript available.



Sole Proprietorships

The **sole proprietorship** is the oldest and most common form of business ownership; the vast majority of businesses are legally organized as sole proprietorships. The sole proprietorship is very attractive to the new businessperson because it is easy to start with the least amount of cost and legal paperwork. The owner is the business and controls all aspects of its operation, including the profits. There are fewer legal regulations for sole proprietorships, and the business is very flexible to change. You decide what you want to do and do it. Taxes are simple, based on the owner's individual tax rate. When you are ready to move on to something else or retire, you just close up shop and shut down the business.

The difficulties begin when the business expands and grows and additional capital is needed to accommodate this growth. The single owner is the primary source for this funding, which can stretch the family's living style. Likewise, the owner's skill and knowledge are the primary sources for managing and developing the changing business. Limitations here can be detrimental to business expansion. Last but not least, if the business is struggling, the full liability of the business debts and financial needs can impose critical limitations and stress on the owner's personal life and family. What do most sole proprietors do when they need an infusion of capital or skill to expand and grow their business? Many of them take on one or more partners.



Source: Creatista/iStock/Thinkstock

Partnerships (6 of 11)

Partnerships

The **partnership** is the second most popular form of ownership, allowing risk and responsibility to be shared. If no formal agreement exists, the partnership is guided by the Uniform Partnership Act, a set of rights and partner obligations. Ultimately, trust and mutual respect have the greatest effect on the success of a partnership. The old adage "two heads are better than one" comes to mind when it comes to partnerships. The pooling of resources, time, funding, and knowledge provides a business with all the more opportunity to succeed and grow.

Like a sole proprietorship, a partnership is relatively easy to establish; there is little regulation, and taxation continues to be based on the individual owner's tax rate. This additional assistance and security is not without its drawbacks:



Source: Ingram Publishing/Thinkstock

- You are now sharing the ownership of your business.
- You share decisions, profit, and control, yet retain unlimited liability (except for limited partners) and concern over the business's perpetuity.
- The largest drawback is the potential for conflict. Partnership disagreements are so common that marriage counselors have expanded their services to provide counseling to business partners (Alboher, 2007).

There are different types of partnerships, including the limited partnership, master limited, and limited liability.

Franchises (7 of 11)

Franchises

A **franchise** is similar to a partnership in that the owner's control and profits are shared somewhat with the franchiser. The extent of this sharing differs from franchise to franchise, as do the benefits the franchisee receives from the arrangement. If you purchase a popular franchise with good products, services, and business systems, you can see your business grow and expand much more quickly than if you were on your own. The potential risk for failure can be decreased if the franchise and the contractual arrangements are reasonable.

Franchise Examples

Franchise agreements, fees, start-up costs, and terms vary widely, as do the types of franchises available. Below are links to franchise examples:

[Anytime Fitness](https://www.anytimefitness.com/franchise-opportunities) (https://www.anytimefitness.com/franchise-opportunities)

[Gigi's Cupcakes](http://gigiscupcakefranchise.com/research-gigis/frequently-asked-questions/) (http://gigiscupcakefranchise.com/research-gigis/frequently-asked-questions/)

[SERVEPRO](https://www.servpro.com/franchise-opportunities) (https://www.servpro.com/franchise-opportunities)

[Dairy Queen](http://www.dairyqueen.com/us-en/Company/Franchise-With-Us/?localechange=1&) (http://www.dairyqueen.com/us-en/Company/Franchise-With-Us/?localechange=1&)

[Hampton by Hilton](http://www.hiltonworldwide.com/development/) (http://www.hiltonworldwide.com/development/)

[Subway](https://www.subway.com/subwayroot/Own_a_Franchise/FranchiseFAQs.aspx) (https://www.subway.com/subwayroot/Own_a_Franchise/FranchiseFAQs.aspx)

[EcoWater](http://dealer.ecowater.com/become-dealer.html) (http://dealer.ecowater.com/become-dealer.html)

[Message Envy](http://www.messageenvyfranchise.com/) (http://www.messageenvyfranchise.com/)

[Supercuts](http://www.supercutsfranchise.com/) (http://www.supercutsfranchise.com/)

On the other hand, a poor product or service line, poor franchise services, or high fees and royalties can be more of a drain on the fledgling business than an asset. Regardless, the franchise limits the freedom and control an owner has, which in itself is uncomfortable for many business owners.

All in all, even with the limitations it imposes, franchising as a business concept is booming (Haller & Weisbord, 2015)! Since the Singer sewing machine began selling franchises after the Civil War, franchise opportunities have grown beyond anything business experts had anticipated. Many new

business initiators find the opportunity to establish their business with a proven product and system very attractive. As with any risk and contractual relationship, franchising requires research, clear understanding, and the asking of many, many questions.

Incorporation (8 of 11)

Incorporation

As a business continues to grow, the need for more expertise, financing, and human skills can lead the business owners to consider the advantages of incorporating. A **corporation** is the most complex of the forms of ownership from a legal regulation and taxation perspective, requiring a more complex operational and management structure as well as knowledge base. The expertise of legal and financial/accounting professionals is almost a given in order to handle the complex legal regulations imposed on corporations.

In addition, in a corporation, the ownership and control of the business is not as centralized as in the other forms. You are sharing the success of your ideas and efforts with even more people than in a partnership. But corporations are not without major advantages. The entity status somewhat limits the legal liability and risk an owner carries. Because the corporation also carries the opportunity for perpetual existence and is not tied to any single individual, corporations can more easily obtain capital financing and attract a variety of skills and knowledge that can simplify the requirements for expansion and growth. Corporations tend to attract more of the public's awareness and media attention, thus providing more notoriety in a bigger arena.



Source:
cifoart/iStock/Thinkstock

Collaborate (9 of 11)

Collaborate

If you have never used Blackboard Collaborate, please take time now to familiarize yourself with the technology. You will use it to communicate with your team throughout the semester so that you are comfortable with the technology when it comes time to deliver your final presentation. Remember that **each team member must speak** during the presentation in order to get credit for the assignment; all team members must be in the Collaborate room at the same time for the presentation.

You will need to request a Collaborate room; see instructions on the [Activities page in Lesson 3](#). Once you receive the link for your Collaborate room, you may start using it to meet with your group. Think about Collaborate as a room where you will meet with your team, much like you would do if you were preparing a presentation in a traditional classroom. Many of the same conventions apply in Collaborate as in a traditional classroom. For instance, you will want to schedule time to meet with your teammates in your room to discuss and practice your presentation, use a visual aid (like PowerPoint) on the Collaborate whiteboard to enhance your presentation, and follow good presentation practices (like not reading from the slides) if you want a good grade.

When using Collaborate, if you want to make someone a moderator, highlight the person's name, go to **Tools**, and scroll down to "Moderator." Once you have practiced your presentation and are ready to present, you will press the **Record** button. When you finish, you will press **Stop**. Collaborate will e-mail you a link to the presentation (note that processing time is needed for the recording, so you will not receive the link immediately). If you need to re-record your presentation, have everyone leave the room, wait two minutes, and then log back in to the room and re-record. This will provide you with a "clean" session to upload. Once you receive the link to the recording via e-mail, you will submit the link to the instructor to grade.

If you are having difficulty contacting team members or your team has members who are not pulling their weight, please contact the instructor—team members who do not participate in the group project will receive a zero (0) for the assignment. Also note that you have the ability in ANGEL to forward e-mail to another e-mail address that you check more often. Please take advantage of this option if needed in order to read and respond to team e-mails in a timely manner.

In the past, several groups have had difficulty creating and recording their group presentations because they did not take time to familiarize themselves with the technology prior to the due date. Be prepared so this doesn't happen to you.

References (10 of 11)

References

- Alboher, M. (2007, November 29). Like marriage, business takes work. In *The New York Times: Shifting careers*. Retrieved from <http://www.nytimes.com/2007/11/29/business/smallbusiness/29sbiz.html>
- AllBusiness Video. (2008, April 23). What is the legal definition of a franchise? [Video file]. Retrieved from <https://www.youtube.com/watch?v=i9DaIV31Z4g>
- Costa, C. (2012, January 25). Choosing your legal business type [Video file]. Retrieved from <https://www.youtube.com/watch?v=i7PulXuCI4w>
- Haller, M. and Weisbord, J. (2015, January 7). *Franchise businesses projected to again grow faster than the rest of the economy in 2015*. Retrieved from <http://www.franchise.org/franchise-businesses-projected-to-again-grow-faster-than-the-rest-of-the-economy-in-2015>
- Quaker Steak & Lube. (2008, December 4). Quaker Steak and Lube brand video [Video file]. Retrieved from <https://www.youtube.com/watch?v=ApClRer6WQ4>

Lesson Assignments (11 of 11)

Lesson 2 Assignments

Complete all the following tasks and readings by the due dates listed in the [course syllabus](#).



Online Video

Watch the following video (Quaker Steak & Lube, 2008) to provide additional background for franchising:

Video 2.3. Tutorial: Quaker Steak and Lube Brand Franchising



Time: 00:06:52

No transcript available.



Discussion Forum

Following the [Discussion Forum Guidelines](#), participate in the following discussion forum topic. Your initial discussion post is due by **Thursday at 6:00 p.m. (ET)**. Your responses to your classmates' initial posts are due by **Sunday at 11:55 p.m. (ET)**, as outlined in the [course syllabus](#).

Discussion Forum 3: Franchises (5 points)

State the pros and cons of belonging to a franchise. Research three different franchises and state the costs of each. Be sure to state your sources and read others' posts before you post so that you do not duplicate findings. Create one original post for this discussion and respond to two of the posts from other students. Please post your responses to [Discussion Forum 3: Franchises](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=Discussion+Forum+3:+Franchise>) .

Service Learning Project Proposed Schedule



During Lesson 1, you began your service learning project. As outlined in the [Service Learning Project Guidelines](#), you should locate a small business where you can volunteer eight hours of your time. Begin working on your project and submit your [Service Learning Project Proposed Schedule Form](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=Service+Learning+Project+Proposed+Schedule>) to the [SLP Proposed Schedule drop box](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=SLP+Proposed+Schedule+Drop+Box>).

Study for Quiz 1

In order to prepare for the first quiz, review the reading materials throughout this lesson.

Please direct questions to the [World Campus HelpDesk](#) (<http://student.worldcampus.psu.edu/student-services/helpdesk>) |

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